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PERSpectives

Fourth Quarter 2003 Public Employee Retirement System of Idaho

PERSI Board recommends full COLA for retirees

Have world financial markets turned the corner? Will PERSI's annual portfolio earnings return to the expected 8% or more this year? Can PERSI afford to grant retirees the full 2.2% cost of living increase (COLA) starting March 1, 2004? Should the COLA include a retroactive 0.8% discretionary sum not provided last year? Or, should the COLA be held to 1% again this year?

These were some of the questions your Board considered at its November meeting to determine what COLA to recommend to the legislature this year.

Portfolio earnings the past three years have been below the threshold 8% return expected over time. In fact, in 2001 and 2002, losses were experienced for the first time since 1984. As a result no discretionary COLA (above the 1% mandatory amount) was granted last year to our 24,018 retired members.

Fiscal Year 2003 investment returns improved to 3.7%. As of December, Fiscal Year 2004 returns are running at 11% year-to-date and over 20% for the calendar year.

With record levels of economic stimuli in the markets–high defense spending, low interest rates, tax cuts, and rapidly improving corporate profits–most advisors are forecasting continued good markets for at least the remainder of the Fiscal Year (June 2004).

Jody B. Olson
Chairman,
Retirement Board

The Board is cautiously optimistic that world financial markets will be strong enough over the next seven months to maintain or improve on the current investment return. This would fund the full 2.2% retiree COLA and also reduce the unfunded liability amortization period.

PERSI is in business "to provide a secure retirement for public employees." Part of that mission is to provide COLAs whenever possible.

In the late 1980s the Board was forced to forego discretionary COLAs three times. We learned that missed COLAs are expensive to make up, but in the 1990s we did provide retro-COLAs to make up for those missed discretionary COLAs.

This year, although we are recommending the full 2.2% COLA, we are not able to grant a retro-COLA to make up for last year.

Currently, all PERSI retirees have 99.2% purchasing power and the average benefit is $931/month.

Our system is strong with over $7 billion in assets. Unlike some of our neighboring states, we have avoided big swings in benefits or contributions.

The 2004 COLA recommended to the legislature is 2.2%. Unless it is changed, the increase goes into effect March 1, 2004.

Since PERSI began in 1965, the legislature has always agreed with the Board's COLA determination.

An example of how COLAs raise a PERSI retiree's monthly benefit

Ten years ago in 1994, Rebecca Retiree received what was then the average benefit amount of $508. With PERSI COLAs, Rebecca now receives $646 per month. With the COLAs, Rebecca's benefit has kept up with inflation, at 99.2% purchasing power.

Most private pension plans do not offer COLAs. So, if in 1994 Peter Private Plan received the same $508, he would still be receiving that same $508, falling far behind Rebecca and her PERSI benefit.

Proposed 2004 legislation affecting PERSI

PERSI has the following pieces of proposed legislation for the 2004 session.

Death Benefit Waiver

Currently, Idaho Code 59-1361(4) permits the designated beneficiary of a PERSI death benefit to waive the benefit and have it paid to the member's surviving spouse.

At times, a beneficiary may wish to waive the death benefit when there is no surviving spouse. Or, a beneficiary who is a surviving spouse sometimes wants to waive the benefit and have it paid to the member's heirs through the estate.

Because of the limiting language in section 59-1361, in such situations the beneficiary has been required to formally renunciate the benefit. This is burdensome because it requires filing court documents and generally requires the services of an attorney.

This bill amends section 59-1361(4), Idaho Code, to permit designated beneficiaries to simply waive their death benefit for whatever reason. This will allow beneficiaries to more easily make the benefit available to other family members.

The beneficiary would only be required to sign a notarized waiver form rather than having to file court documents. If a beneficiary waives a benefit under the amended law, the benefit would be paid as if the beneficiary had predeceased the member–the same way it is currently paid under the renunciation statute.

If the beneficiary waives his or her right and there is a surviving spouse, the spouse will be the first to receive the benefit. If there is no surviving spouse, the benefit will be paid to the member's estate.

FRF COLA

The Firefighter's Retirement Fund (FRF) statutes require that PERSI annually calculate the "Statewide Firefighter Average Salary" which is used for the calculation of the FRF retiree COLA (Idaho Code 72-1471) and for setting Option I firefighter contributions (Idaho Code 72-1434(1)).

Idaho Code 72-1432 provides that the Average Salary is calculated from wages paid to "paid firefighters" from September 1 to August 31 of the following year.

This has become increasingly difficult because PERSI's new data system and procedures now require that employers report on a pay period basis (not monthly when paid). Additionally, one month is not adequate time to process all the information and get the new contribution rates back to employers in a timely fashion.

This bill amends section 72-1431 and 72-1432, Idaho Code. First, it converts the compensation component to salary ***earned*** in a particular pay period rather than salary **paid** in a month. Second, it changes the measurement period to July 1 through June 30 (rather than September 1 through August 31), to match the state fiscal year and to provide additional time for employers to change their payroll deductions.

These changes will have no impact on the FRF members and will be administratively easier for employers and PERSI.

ORP Eligibility

This bill deals with an eligibility issue created by the interplay between PERSI and the Optional Retirement Plans (ORPs) of universities.

Because of the way "employee" is defined in Idaho Code 59-1302(14), it is possible for ORP covered employment to be counted toward PERSI eligibility in cases of dual employment.

This means that a person could be eligible for PERSI with one employer even if they work less than 20 hours per week for that employer. This creates administrative problems because there is no practical way for that employer to track hours with the ORP covered employer.

This bill would amend section 59-1302(14) to clarify that ORP-covered employment cannot be considered in reaching eligibility requirements for PERSI-covered employment.

Legislative Updates Available on PERSI's Website

As always, we have a link to our legislative page on our website's homepage at www.persi.state.id.us. We make regular updates to this page during the legislative session.

NEW on the PERSI Website

Unclaimed Funds Search for Inactive Members

Someone you know may have "forgotten" money available to them. PERSI's website now has an Unclaimed Funds Search for Inactive Members. The search allows former public employees (who are not retirees) to see if they have PERSI Base Plan money available to them. They do not have to withdraw the funds, but if they wish to, they may. If they are vested to a lifetime pension, the search will inform them of this. It is at **www.persi.state.id.us** under "Account Information" and "Unclaimed Funds Search for Inactive Members."

2004 interest rates

Interest Paid to Members

Effective January 1, 2004, the regular interest rate members receive on their PERSI Base Plan account is 3.22% for the year.

The regular interest rate credited to member accounts is equal to PERSI's net investment return rate. The rate for each calendar year is based on the annual net rate of return at the end of the previous fiscal year (June 30). PERSI realized a net return of 3.22% for fiscal year 2003.

Interest Paid for Buybacks

The interest charged to members who are making repayments to the Base Plan for 2004 is 6.17%. This is based on the 3-year average of the Prime Rate plus 1% (determined as of June 30 the previous year). Any interest paid by a member goes into his/her own account, not to PERSI.

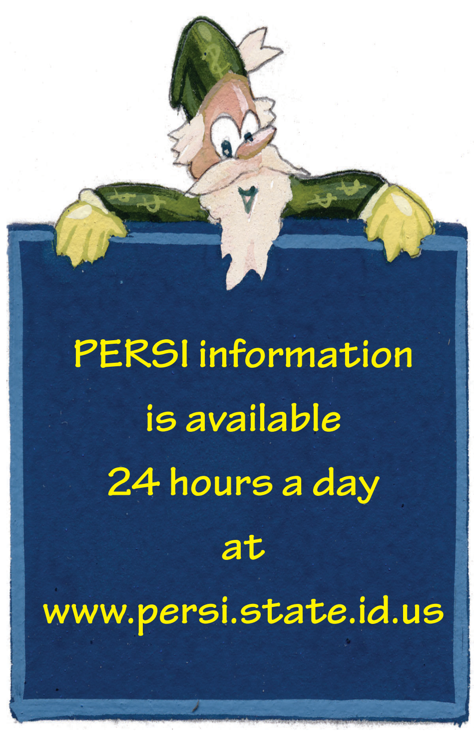
If you are currently making payments, and want to begin additional payments to pay off the total faster, you may do so at the same locked interest rate of the original payment.

There is no limit on how long you may take to repay as long as you cover the interest. If you terminate work, you may continue to make taxed payments at the locked-in rate.

You may contribute more to the Choice Plan 401(k) in 2004

You may now increase your contributions to the PERSI Choice Plan 401(k). The 2004 contribution limit is $13,000 (or, if you are least age 50 during the year, $16,000).

You may contribute any percent of your pay until you reach the limit. See your payroll office to complete a new Salary Reduction Agreement or to change your deferral.



Choice Plan policy changes

Over the last several months, there has been some media attention on market timing or excessive trading in mutual funds and 401(k) plans. Such trading by a few individuals may negatively affect the rest of the Choice Plan participants who use these funds in their long-term retirement portfolio. This type of trading has the potential to increase costs to other participants, skew the performance of the fund, and could also lower returns for long-term shareholders.

With an eye toward the responsibility to protect participants' assets, the PERSI Board has revised the Choice Plan investment policy to stress to participants that the 401(k) was developed as a vehicle for long-term accumulation of retirement savings, and that market timing and excessive trading are discouraged because they can be detrimental to other participants in the plan.

Further discussions of this issue and possible actions to take will occur at the January Retirement Board meeting, and we will notify members of any plan trading policy modifications.

Invest with inflation in mind to protect savings

Inflation has taken a back seat to other financial planning topics lately because the inflation rate for the past several years has been relatively low. However, when you are saving for the future, such as when investing for your retirement, inflation—even at a low rate—can have a significant impact over a long period of time.

In simple terms, inflation is the increase in the cost of living, expressed as a percentage increase over the previous year. For example, a 3% inflation rate means that the cost of living increased by 3% from the previous year. Inflation is a normal part of the economy and usually ranges between 2% and 4% each year.

The PERSI Base Plan adjusts retirement benefits each year to reflect changes in the cost of living. But with other savings vehicles, such as your 401(k) or an IRA, inflation can erode the value of your savings in two ways:

1. Inflation reduces the return on your investments. For example, if your investments are earning an 8% annual return, a 3% rate of inflation means that your real rate of return is only 5%.
2. Inflation reduces the purchasing power of your money. For example, at 3% annual inflation, you'll need almost $7,000 in 30 years to purchase what $3,000 buys today.

If you overlook inflation, you might make the mistake of saving less for your retirement than you need to.

An Example of Inflation's Effect on Your Savings

If you retire in your early 60s, you could spend another 25 to 30 years living on your retirement savings. Below, see how a 3% inflation rate could affect your retirement income needs. Let's assume that your pre-retirement final pay is $50,000 and that you need 70% of that amount ($35,000) to live comfortably your first year in retirement.

Annual Income Needed to Maintain Standard of Living

Year 1	$	35,000
Year 5	$	39,400
Year 10	$	45,700
Year 15	$	52,900
Year 20	$	61,400
Year 25	$	71,100
Year 30	$	82,000

Just to keep pace with inflation, you'll need an annual retirement income of $39,400 in your 5th year of retirement, $52,900 in your 15th year and $71,100 in your 25th year.

How Do You Protect Yourself from Inflation?

To help protect yourself from inflation, you need investments whose returns will exceed, or at least keep pace with the inflation rate. Keep in mind that over long periods of time, the returns of a diversified portfolio of stocks and bonds historically have outpaced inflation. If your account is composed of only conservative investment options, such as stable value investments, it may not keep pace with inflation, and you could run the risk of not having enough saved when you are ready to retire.

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